

LEGAL REVIEW NOTE

Bill No.: SB350

LC#: LC0901 To Legal Review Copy, as of
February 28, 2017

Short Title: Providing for a new uppermost tax rate

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CONFORMITY WITH STATE AND FEDERAL CONSTITUTIONS

As required pursuant to section 5-11-112(1)(c), MCA, it is the Legislative Services Division's statutory responsibility to conduct "legal review of draft bills". The comments noted below regarding conformity with state and federal constitutions are provided to assist the Legislature in making its own determination as to the constitutionality of the bill. The comments are based on an analysis of jurisdictionally relevant state and federal constitutional law as applied to the bill. The comments are not written for the purpose of influencing whether the bill should become law but are written to provide information relevant to the Legislature's consideration of this bill. The comments are not a formal legal opinion and are not a substitute for the judgment of the judiciary, which has the authority to determine the constitutionality of a law in the context of a specific case.

This review is intended to inform the bill draft requestor of potential constitutional conformity issues that may be raised by the bill as drafted. This review IS NOT dispositive of the issue of constitutional conformity and the general rule as repeatedly stated by the Montana Supreme Court is that an enactment of the Legislature is presumed to be constitutional unless it is proven beyond a reasonable doubt that the enactment is unconstitutional. See Alexander v. Bozeman Motors, Inc., 356 Mont. 439, 234 P.3d 880 (2010); Eklund v. Wheatland County, 351 Mont. 370, 212 P.3d 297 (2009); St. v. Pyette, 337 Mont. 265, 159 P.3d 232 (2007); and Elliott v. Dept. of Revenue, 334 Mont. 195, 146 P.3d 741 (2006).

Legal Reviewer Comments:

LC0901 is an act that revises the rate of tax imposed on a individual income taxpayer with more than \$500,000 in taxable income. Under current law, the rate of tax for this level of income is 6.9%, and the proposed amendment increases the rate of tax to 7.9%. The proposed increase applies retroactively to tax years beginning after December 31, 2016 (*i.e.*, tax year 2017).

LC0901, as currently drafted, may raise a potential constitutional issue on due process grounds given the retroactive nature of the tax increase, as taxpayers would pay a higher rate of tax on

income that has already been earned.

Article II, section 17, of the Montana Constitution¹ provides:

No person shall be deprived of life, liberty, or property without due process of law.

The Montana Supreme Court has invalidated a prior denial of a tax deduction to a business because it required retroactive application and violated due process. In First Federal Sav. & Loan Ass'n v. Dept. of Revenue, 200 Mont. 358, 365-366, 654 P.2d 496, 499-500 (1982)², a business incurred a corporate net operating loss in each of the 5 years from 1974 through 1978. In 1979, the Legislature amended the net operating loss statute by providing that prior net operating losses needed to be recalculated based on current law.³ When the business relied on the law in effect prior to the amendment, the Department of Revenue recalculated the net income of the business for 1974 through 1978, which resulted in no net operating losses to carry forward to 1979.

The business challenged the denial of the deduction, and the Montana Supreme Court held that the legislative amendment was unconstitutional because it required retroactive application, was in violation of the due process clause of the federal and state constitutions, and imposed a new duty on the business. In making this determination the Montana Supreme Court reasoned that a "retroactive law is one that takes away or impairs vested rights acquired under existing laws or creates new obligations or imposes new duties in respect to transactions already past." Id. at 366, 654 P.2d at 500.

It should be noted that this is a developing area of the law, and that in United States v. Carlton, 512 U.S. 26 (1994), the United States Supreme Court considered the question of whether Congress had the power to impose a retroactive amendment to a federal estate tax statute. The decision stands for the proposition that Congress has the authority to impose a retroactive tax provision if it is supported by a legitimate legislative purpose furthered by rational means. Id. at 35. In Carlton, the legitimate purpose was satisfied because Congress "acted to correct what it reasonably viewed as a mistake in the original . . . provision that would have created a significant and unanticipated revenue loss." Id. at 32. It is unclear whether the Montana Supreme Court would consider raising revenue as a

¹ Article II, section 17, Mont. Const., is identical to Article III, section 27, of Montana's 1889 Constitution.

² First Federal was reversed on other grounds in Schwinden v. Burlington N., 213 Mont. 382, 691 P.2d 1351 (1984). The reversal pertained to the holding on the first issue in First Federal that "income from federal obligations may not be considered in computing corporate taxes due under the Montana corporation license tax". Id. at 398, 691 P.2d at 1359. The reversal did not pertain to the third issue in First Federal regarding retroactivity.

³ Sec. 3, Ch. 634, Laws of 1979. The amendment at issue provided: "Any net operating loss carried over to any taxable years beginning after December 31, 1978, must be calculated under the provisions of this section effective for the taxable year for which the return claiming the net operating loss carryover is filed." Section 15-31-114(2)(b)(ii)(C), MCA (1979).

legitimate legislative purpose that can justify a retroactive tax increase, and Carlton has not been cited in a Montana Supreme Court opinion.

As applied here, LC0901 may potentially be in conflict with Article II, section 17, given that the draft bill would impose a new income tax obligation on taxpayers that have already earned income that was previously subjected to tax at a lower rate.

Requester Comments: